

Governor's Transition Document

September 17, 2004

Agency Name

The Washington State Liquor Control Board
3000 Pacific Ave. SE, Olympia, WA 98504-3080
Phone: 360-664-1600 Website: www.liq.wa.gov
Pat Kohler, Administrative Director

Mission Statement

The mission of the Liquor Control Board is to serve the public by preventing the misuse of alcohol and tobacco through controlled distribution, enforcement, and education; and provide excellent customer service by operating efficient, convenient, and profitable retail stores.

Agency Facts

- Number of employees: 961 FTE employees in 2003-2005.
- Total annual wholesale and retail sales: \$605 million in 2004.
- Cost of product in 2004: \$280 million.
- Other agency annual operating expenses in 2004: \$82 million.
- Revenue to state after product/operating expenses: \$243 million in 2004.
- Number of stores: 160 state-operated stores; 154 contract stores.
- Number of businesses licensed to sell, distribute, manufacture or import alcohol: 13,000.
- Authorizing Statutes: RCW 66.08.012; RCW 66.08.030; RCW 66.08.050.
- Facilities: Headquarters Olympia; Distribution Center, Seattle; Enforcement Offices/Stores statewide.

Agency Responsibilities

- **Control the sale and distribution of all spirituous liquor through a system of more than 314 state and contract liquor stores and by licensing and regulating all businesses producing, selling, distributing or importing alcohol in the state.**
- Receive, store and ship product to state and contract stores and to military and tribal stores from a Seattle Distribution Center.
- Issue licenses to more than 13,000 businesses selling, distributing, importing or producing liquor, beer or wine in the state.
- **Provide oversight for a three-tier system of distribution for beer and wine by enforcing mandatory 10 percent markups between producers, distributors and retailers and other control mechanisms designed to create a stable and orderly market, discourage over-consumption and eliminate predatory pricing practices.**
- **Enforce all state laws regulating the sale, importation, production and distribution of alcohol. Conduct regular compliance checks for over-service and service to minors.**
- Conduct regular public meetings to review and approve changes in rules, recommend changes in statutes, hear stakeholder input, and provide policy oversight for the agency.
- **Conduct education and prevention activities to reduce adult alcohol abuse and consumption by minors.**

Resp to Costco RFP
1363

**DEFENDANT'S
EXHIBIT**

CASE
NO. C04-0360P

EXHIBIT
NO. 570

Balanced Mission

Revenue Generation

Our mission is to maximize revenue to the state by operating efficient, convenient and profitable retail stores. Gross bottle sales have increased 23 percent since 1996 and are expected to continue to increase at a 4.8 percent annual rate. Some interest groups continue to advocate privatization of our \$600 million annual business. Studies have proven this would cost the state hundreds of millions of dollars in revenue. The WSLCB will contribute more than \$3 billion in revenue to the state in the next decade if investments are made now to ensure future growth.

Retail Business Development

- Increase Number of Store Employees
- Increase Number of Stores
- Improve Store Profitability
- Create New Store Types
- Improve Product Display
- Implement New Wine Strategy
- Improve Inventory Management
- Improve Strategic Planning
- Improve Financial/Accounting Systems

Distribution Center

- Expand DC Size/Capacity
- Improve Product Handling System
- Create Better Back-up Systems
- Implement New Freight Delivery Contract
- Improve Employee Safety/Training
- Meet Stakeholder Concerns

Customer Service

- Better Trained Employees
- Improve Product Information
- Improve Point-of-Sale Systems
- Improve Store Layouts
- Improve Signage
- Create Safer Stores

Public Safety

Our control system is designed to increase public safety by controlling access to spirits

and by promoting effective statewide treatment, education, prevention and enforcement programs. Stakeholders in the food and entertainment communities and the alcohol industry pay careful attention to proposed changes in legislation, rules and policy and will aggressively pursue their own agendas such as Sunday sales and direct shipping. Community and advocacy groups also seek greater support to curb alcohol abuse

Enforcement

- Improve Alcohol/Tobacco Compliance
- Improve Employee Training/Retention
- Manage Increased Span of Authority
- Enforce More Complex Laws

Licensing

- Improve Customer Service
- Manage Rapid Growth in Licensees
- Increased Regulatory Complexity
- Law, Rule, Policy Revisions
- Increased Legal Actions
- Recovering Costs of New Initiatives
- Increased Community Initiatives

Education

- Increase Licensing Workshops
- Continue/Expand Diversity Programs
- Conduct Statewide Awareness Campaign
- Alcohol Education Advisory Committee

Employee Development

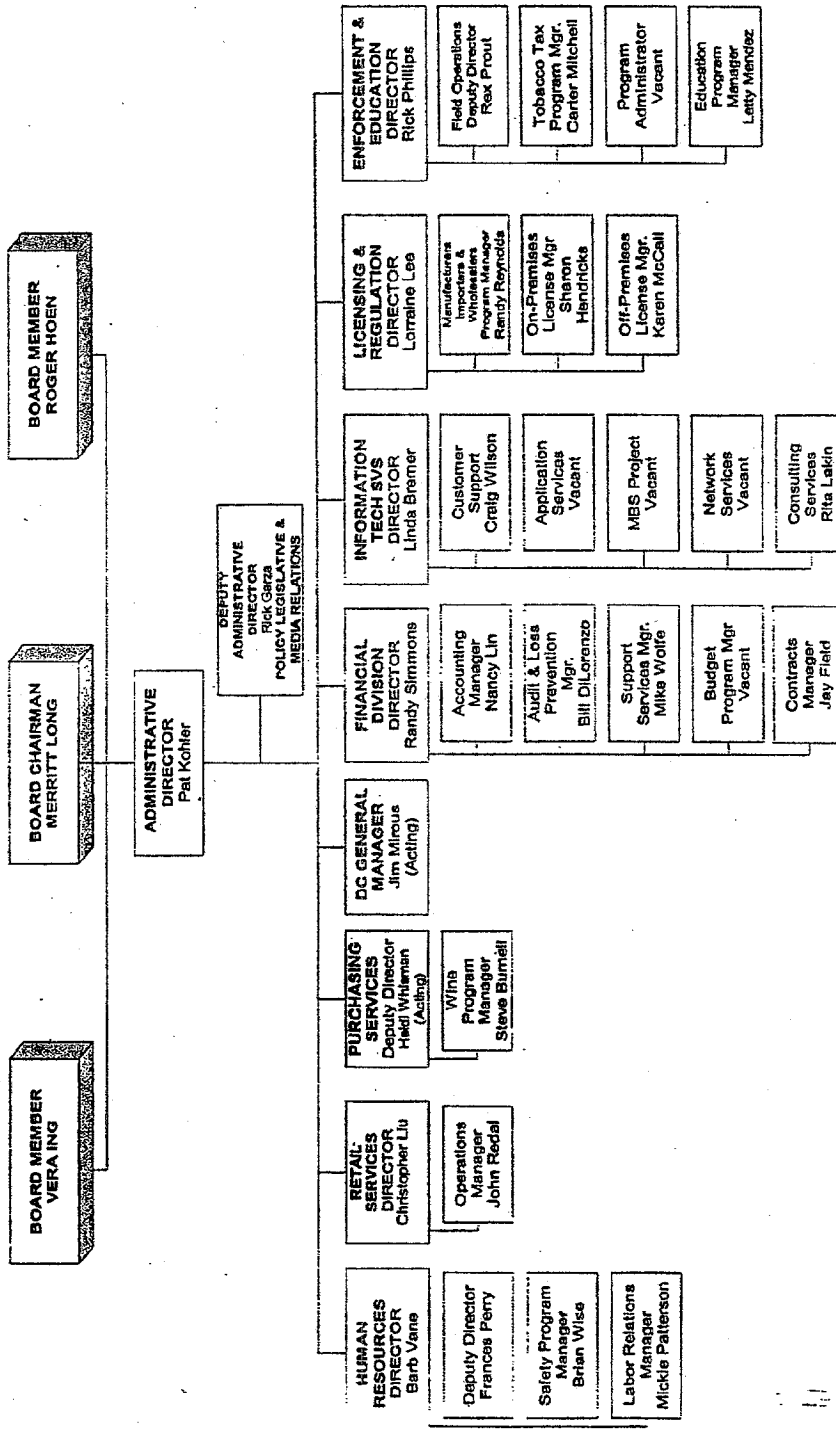
- Provide Mandatory Training
- Provide Career Skills Training
- Continue Policy Development
- Provide CSR Assistance
- Improve Labor Relations

Resp to Costco RFP
1364

Organization Chart

WASHINGTON STATE LIQUOR CONTROL BOARD

September 2004



Budget by Source and Program

2003-2005

| Program | General Fund 001 | Liquor Rev. Fund (App) 501 | Liquor Rev. Fund (Non-App) 501 | Construction & Maintenance 335 | Total |
|-------------------------------------|---------------------|-------------------------------|-----------------------------------|-----------------------------------|-------------------------------|
| Board 010 | 297,344 | 5,706,566 | 0 | 0 | \$ 6,003,910 |
| Admin. Services 020 | | 11,041,933 | | | \$11,041,933 |
| Liquor Purchasing & Dist. 040 | | 34,617,960 | 19,077,108 | 5,717,000 | \$119,412,068 |
| Regulatory Services 050 | | 4,379,384 | | | \$4,379,384 |
| Enforcement 060 | 2,651,793 | 9,874,789 | | | \$12,586,582 |
| Information Services 070 | | 10,949,032 | | | \$10,949,032 |
| Total Fund | \$2,949,137 | \$136,569,664 | \$19,077,108 | \$5,717,000 | Total Agency \$164,312,909 |

Resp to Costco RFP
1366

Most Pressing Issues or Challenges

Sustain Continued Growth in Liquor Sales

Retail Sales Growth

During the last four years, when sales tax revenues were falling statewide, the WSLCB returned record revenues to the state. This contribution in a time of need lent support to the agency's proposal, in the 2003 biennium, to add five new stores, further increasing revenue potential. These stores were approved – the first new stores approved in 23 years. During the coming decade, the WSLCB has the potential to return more than \$3 billion in revenue to the state if it is allowed to continue to add new personnel, stores and equipment to serve a growing statewide customer base.

The agency has increased revenue returned to the state at an annual rate of nearly 5 percent during the last seven years. About \$243 million was returned in 2004. Much of this has resulted from higher gross sales totals. Total agency revenues from all sources reached \$605 million in 2004. Statewide growth in the number of drinking-age adults, an increase in the number of licensed establishments and consumers 'buying up' all contribute to increased gross sales. Total sales should continue to increase at a rate of 4.8 percent annually for the foreseeable future based on population growth estimates and consumption trends.

Stores are currently under-staffed in the wake of this growth. There are fewer store hours appropriated now than there were seven years ago. As liquor sales have grown rapidly, store personnel have been stretched to the limit. Additional store FTEs and additional stores are needed to increase revenue and serve the state's growing population. Four new stores are being requested for 2005-2007. These four new stores will produce an estimated \$17 million in total sales annually, which equals a return to the state of \$6.5 million.

Distribution Center Capacity

The agency's Seattle Distribution Center, which serves more than 360 state, contract, military and tribal stores, is operating at maximum capacity. The agency has proposed a \$17.5 million expansion of the center for 2005-2007. Without this plant capacity, the DC will not be able to supply our stores with enough product to meet demand and we will begin to lose sales. This will reduce revenue returned to the state now and hurt our long-range revenue generating potential substantially.

Technology

Many technology upgrades have been implemented in the stores and Distribution Center during the last two years. More are needed to help us catch up and move ahead after years of under-funding. New technology is one of the agency's top priorities, as the WSLCB strives to improve customer service and manage our business and regulatory operations more strategically.

Resp to Costco RFP
1367

Pressure to Privatize Liquor Sales

The state's role in the sale of liquor has been the subject of many discussions, studies, and legislative proposals during the last two decades. Three privatization studies have been conducted. Each of these studies concluded the public's interest is best served by the state's controlled distribution system.

- A Task Force formed by Gov. Gary Locke issued a report on privatization in 2002. It concluded the state's control system provides significant revenue and health benefits to citizens.
- In the early 1990s Gov. Mike Lowry proposed legislation to privatize the sale of liquor. This legislation died in committee.
- In the 1980s, former Republican Gov. John D. Spellman issued a report from his budget office examining the feasibility of privatizing liquor sales.

Gov. Spellman's report concluded: "A financial comparison of a free enterprise liquor system with the present control system indicates there would be a loss in liquor revenues to the state if the state changed to a free enterprise system." The report reached this conclusion because there is more to this story than simple profit and loss.

The annual loss of revenue under a privatized system was estimated at \$43 million by Gov. Locke's study, which was completed in 2002. In addition, it would increase costs associated with alcohol abuse by more than \$200 million annually. Washington's control system contributes to lower per-capita consumption of alcohol – as much as 1 1/2 gallons annually per person.

In 2004, the \$243 million in revenue returned by the agency supported the following state services:

- 55% to General Fund
- 19% to Cities/Counties
- 17% to Health Services
- 8% to Education/Prevention
- 1% to Research

Resp to Costco RFP
1368

Legal Challenges

Costco vs. Hoen, et al.

Costco filed suit in early 2004 against the Liquor Control Board members, in their official capacities, seeking to overturn the laws establishing the state's three-tier distribution system for beer and wine. The case is currently before a U.S. District Court judge in Seattle and is not expected to go to trial before the fall of 2005. A team of attorneys from the Washington Attorney General's Office is defending the state. The Washington Beer and Wine Wholesalers Association (WBWWA) has intervened in the suit as a defendant.

Three-tier systems are common throughout the United States in control and non-control states. Under Washington's laws, manufacturers may sell to licensed distributors (middlemen), who in turn may sell to licensed retailers. Manufacturers are prohibited from selling directly to retailers. Both manufacturers and distributors must sell at a minimum of a 10 percent markup and are prohibited from offering quantity discounts or selling on credit. The primary purpose of this system is to prevent manufacturers from exercising control over the retail market, which could destabilize prices and encourage predatory pricing practices and over-consumption.

Costco seeks to overturn laws establishing

- minimum markups
- a ban on credit purchases by retailers
- a ban on direct shipping from out-of-state manufacturers to retailers
- a ban on warehousing by retailers
- a ban on quantity discounts
- price posting requirements on distributors

Costco alleges state laws establishing the three-tier system violate the federal Sherman Anti-Trust Act and the Constitutions of the United States and the State of Washington. The state maintains it has the right to regulate alcohol importation, distribution, sale and manufacture under the 21st Amendment to the Constitution, which repealed prohibition. It further disputes Costco's anti-trust claims. U.S. Circuit Courts have handed down differing decisions on issues of law central to the Costco suit. It is expected the final resolution to this suit may come from the U.S. Supreme Court.

Direct Shipping Case Before U.S. Supreme Court

A pending appeal before the U.S. Supreme Court is likely to impact the WSLCB's regulation of interstate shipment of wine or beer and the outcome of the Costco lawsuit. The issue before the Supreme Court is whether it is a violation of the dormant Commerce Clause for a state to restrict out-of-state wineries from shipping wine directly to consumers, yet allow in-state wineries to do so, in light of the broad powers granted to the states by the 21st Amendment.

Currently, many states restrict the interstate sale and direct shipment of wine to consumers. Washington, for example, has reciprocal shipping agreements with 19 states permitting direct shipments of limited quantities of wine to private consumers. The WSLCB did not file or join in any amicus briefing in this case, though the Washington State Attorney General has indicated an intent to do so.

Resp to Costco RFP
1369